

In re Samuel E. Wyly, et al.
Expert Report of Bruce G. Dubinsky
November 10, 2015

Figure 32: Little Woody LLC Bank of America Statement

Bank of America, N.A.
P.O. Box 798
Wichita, KS 67201

Account Reference Information
Account Number: 15-282211
E O C Enclosures 0 50
Statement Period 02/01/01 through 03/31/01

12999 801 SCH999 1 3 0

LITTLE WOODY, LLC
300 CRESCENT CT STE 1000
DALLAS TX 75201-7852

Customer Service:
Bank of America, N.A.
P.O. Box 798
Wichita, KS 67201
Toll Free 1.888.BUSINESS(1.888.287.4637)

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Business Economy Checking

Account Summary Information

Statement Period	03/01/01 through 03/31/01	Statement Beginning Balance	0.00
Number of Deposits/Credits	1	Amount of Deposits/Credits	4,500,000.00
Number of Withdrawals/Debits	7	Amount of Withdrawals/Debits	4,307,236.88
Number of Deposited Items	0	Statement Ending Balance	192,763.17
Number of Enclosures	0	Average Ledger Balance	796,201.41
Number of Days in Cycle	31	Service Charge	0.00

Deposits and Credits

Date Posted	Amount	Description	Bank Reference
03/02	4,500,000.00	Funds Transfer Credit Fdos Ntr 0001145 NBKA6Y3	945003021460067

Withdrawals and Debits

Other Debits

Date Posted	Amount	Description	Bank Reference
03/05	3,650,823.83	Wire Type: Fed Out Date: 010305 Time: 1613 Fed Ref: 003091 Seq: 010305018493 Bnf: Stewart Title Of Asp Pmt Det: Stewart Title Of Aspen Ac-2020 002275 Rfb- Bnf Elk-Alpine Glenwood S	904003059018493
03/05	35.00	Wire Transfer Fee	904003050017015

72. The “sales” proceeds of \$3,643,227.83 were wired by Stewart Title and were eventually transferred to an investment account in the name of Little Woody, Ltd.¹¹¹ On March 8, 2001, Marmalade, Ltd. received a wire of \$3,643,227.83 from Stewart Title. (See Figure

¹¹¹ The difference between the amount due from buyer at closing of \$3,650,823.83, and the amount paid to seller of \$3,643,227.83, is likely closing fees charged by Stewart Title. Buyer(s) Final Closing Statement, DOJ_HST819120.

33.)¹¹² The next day, March 9, 2001, the same amount was transferred from Marmalade, Ltd. to Little Woody, Ltd. (See Figure 34: Marmalade Ltd. Bank of America Statement and Figure 35: Little Woody Ltd. Bank of America Statement.)¹¹³ Four days later Little Woody, Ltd. transferred the sales proceeds along with the balance in the account up to that date, for a total of \$3,690,511.595 to an investment account. (See Figure 35 and Figure 37: Little Woody Ltd. Banc of America Investment Services Statement.)¹¹⁴

¹¹² Mamalade, Ltd. Bank of America 03/01/01-03/31/01, DOJ_MAR002217 (WYLYSEC00992560).

¹¹³ Mamalade, Ltd. Bank of America 03/01/01-03/31/01, DOJ_MAR002219 (WYLYSEC00992562); Little Woody, Ltd. Bank of America 03/01/01-03/31/01, DOJ_HST092695 (WYLYSEC00120339).

¹¹⁴ Little Woody, Ltd. Bank of America 03/01/01-03/31/01, DOJ_HST092695-DOJ_HST092696 (WYLYSEC00120339-WYLYSEC00120340); Little Woody, Ltd. Banc of America Investment Services, Inc. SEC100005238.

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Figure 33: Marmalade Ltd. Bank of America Statement

Bank of America

Bank of America, N.A.
P.O. Box 798
Wichita, KS 67201

Account Reference Information
Acct: [REDACTED]
Tx: [REDACTED]
B O C Enclosures 6 60
Statement Period 0015207
03/01/01 through 03/31/01

02099 001 SCH999 I 34 0

MARMALADE LTD
300 CRESCENT CT STE 1000
DALLAS TX 75201-7852

Customer Services
Bank of America, N.A.
P.O. Box 798
Wichita, KS 67201
Toll Free 1.888.BUSINESS(1.888.287.4637)

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Full Analysis Business Checking

Account Summary Information

Statement Period	03/01/01 through 03/31/01	Statement Beginning Balance	500,485.86
Number of Deposits/Credits	11	Amount of Deposits/Credits	4,113,547.27
Number of Withdrawals/Debits	12	Amount of Withdrawals/Debits	4,493,506.39
		Statement Ending Balance	121,527.74
Number of Enclosures	6	Average Ledger Balance	473,397.96
Number of Days in Cycle	31	Service Charge	0.00

Deposits and Credits

Transaction and Reference	Amount	Description	Bank Reference
/01	✓10,416.00	Wire Type:Book IN Date:010301 Time:0720 Orig:Maverick Capital General Llc Seq:010301000989 Pmt Det:Marmalade Ltd Mav Cap Ge N Llc Distribution	904003019000989
/05	✓5,634.06	Wire Type:Book IN Date:010305 Time:1611 Orig:Maverick Fund USA Ltd Seq:010305018533 Pmt Det:Marmalade Ltd Bnf=marmal Ade Ltd B O RFB = 0009903060101347 Obi =sender Maver ick Fund USA Ltd	904003059018533
/07	✓4,680.16	Wire Type:Book IN Date:010307 Time:1406 Orig:Maverick Levered LP Seq:010307012856 Pmt Det:Marmalade Ltd Bnf=marmal Ade Ltd B O RFB = 0009903070100674 Obi =sender Maver ick Funded Partner	904003079012856
/08	✓3,643,237.83	Wire Type:Fed IN Date:010308 Time:1435 Fed Ref:0000040 Seq:010308014009 Orig:22 Stewart Title 62 Pmt Det:Little Woody Ltd Ac:4771145433 Bbi=bank Of America Of Dallas, TX SE Nding Bank:Alpine Bk	904003089014009

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Figure 34: Marmalade Ltd. Bank of America Statement

Bank of America

Bank of America, N.A.
P.O. Box 798
Wichita, KS 67201

Account Reference Information
Account Number: [REDACTED]
Tax ID Number: 75-2765513
E.O.C. Enclosures: 6
Statement Period: 09/01/01 through 09/31/01

MARMALADE LTD

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Full Analysis Business Checking

Withdrawals and Debits - Continued

her Debits

Check Number	Amount	Description	Bank Reference
109	✓ 3,643,227.83	Funds Transfer Debit Eden Ntx 0001145 NREOVWS	945003091450125
113	✓ 545,455.58	Wire Type Fed Out Date: 01/03/13 Time: 1308 Fed Ref: 001264 Seq: 010313010149 Bnf: Graham Savings And L Pmt Det: Graham Savings An	904003139010149

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Figure 35: Little Woody Ltd. Bank of America Statement

Bank of America

Bank of America, N.A.
P.O. Box 798
Wichita, KS 67201

Account Reference Information
Acct # [REDACTED]
Tax ID # [REDACTED]
E 0 0 C Enclosures 7 50
Statement Period 03/01/01 through 03/31/01 0017726

02099 001 SCH999 1 1 0

LITTLE WOODY LTD
300 CRESCENT CT STE 1000
DALLAS TX 75201-7852

Customer Service:
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Wichita, KS 67201
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Simple Analysis Business Checking

Account Summary Information

Statement Period	03/01/01 through 03/31/01	Statement Beginning Balance	47,383.76
Number of Deposits/Credits	2	Amount of Deposits/Credits	4,389,546.83
Number of Withdrawals/Debits	9	Amount of Withdrawals/Debits	5,812,109.77
		Statement Ending Balance	524,740.82
Number of Enclosures	7	Average Ledger Balance	618,804.03
Number of Days in Cycle	31	Service Charge	6.17

Deposits and Credits

Date	Amount	Description	Bank Reference
03/08	3,643,327.83	Funds Transfer Credit Fds Ntr 0001146 N8KOVW8	945003091450126
03/14	646,219.00	Funds Transfer Credit Fds Ntr 0001146 N8KOVW8	945003141450081

Withdrawals and Debits

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Figure 36: Little Woody Ltd. Bank of America Statement

Bank of America
Bank of America, N.A.
P.O. Box 795
Wichita, KS 67201

Account Reference Information
Acct: [REDACTED]
Tax ID Number: 75-2666343
B O O C Enclosures 7 50
Statement Period 0017725
03/01/01 through 03/31/01

LITTLE WOODY LTD

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Simple Analysis Business Checking

Withdrawals and Debits - Continued

their Debits

Date	Amount	Description	Bank Reference
3/13	3,690,511.59	Wire Type:Fed Out Date:010313 Time:1637 Fed Ref:002463 Seq:010313015489 BnfNational Financial S Pmt Det:National Financia l Services Ac-066196 221 Bnf Bk:Chase Ncc	904003129016489
3/14	100,000.00	Funds Transfer Debit Fdes Ntx 0001145 NBKA6Y3	945003221450093
3/30	6.17	Overdraft Interest Charge	

Figure 37: Little Woody Ltd. Banc of America Investment Services Statement

Account Statement March 01, 2001 through March 31, 2001
See last page for important information about your linkage agreement and this statement

Customer Name LITTLE WOODY
INVESTMENT CONSULTANT JOHN JONES

Banc of America Investment Services, Inc.™

Activity Summary

	Debits	Credits
Beginning Balance	00	00
Total Securities Purchased	3,690,126.43	00
Income Received	00	7,514.84
Total Deposits	00	3,690,511.59
Ending Balance	00	00

Income Summary

	This Period	Year To Date
Taxable Dividends	7,514.84	7,514.84
Total Taxable Income	7,514.84	7,514.84
Total Income	7,514.84	7,514.84

Account Activity

Cash Account Activity

Date	Description	Debit	Credit	Balance
	*** Opening Balance ***			00 CR
03-13-01	YOU BOUGHT NATIONS CASH RESERVES DAILY @ 1	3,690,511.59		3,690,511.59 DR
03-13-01	WIRE TRANS FROM BANK WFD1265461		3,690,511.59	CR
03-29-01	INVESTMENT NATIONS CASH RESERVES DAILY @ 1		7,514.84	DR

73. Thus, in this example, \$3,643,227.83 of untaxed Wyly Brothers' funds from the accounts of an IOM entity was "invested" back into the U.S. through the "sale" of property owned by the Wyly Brothers. This is another example of the deceptive methods employed by the Wyllys to bring back money to the U.S. tax-free for their personal use.

d. Investment in Artwork – Cheryl Wyly

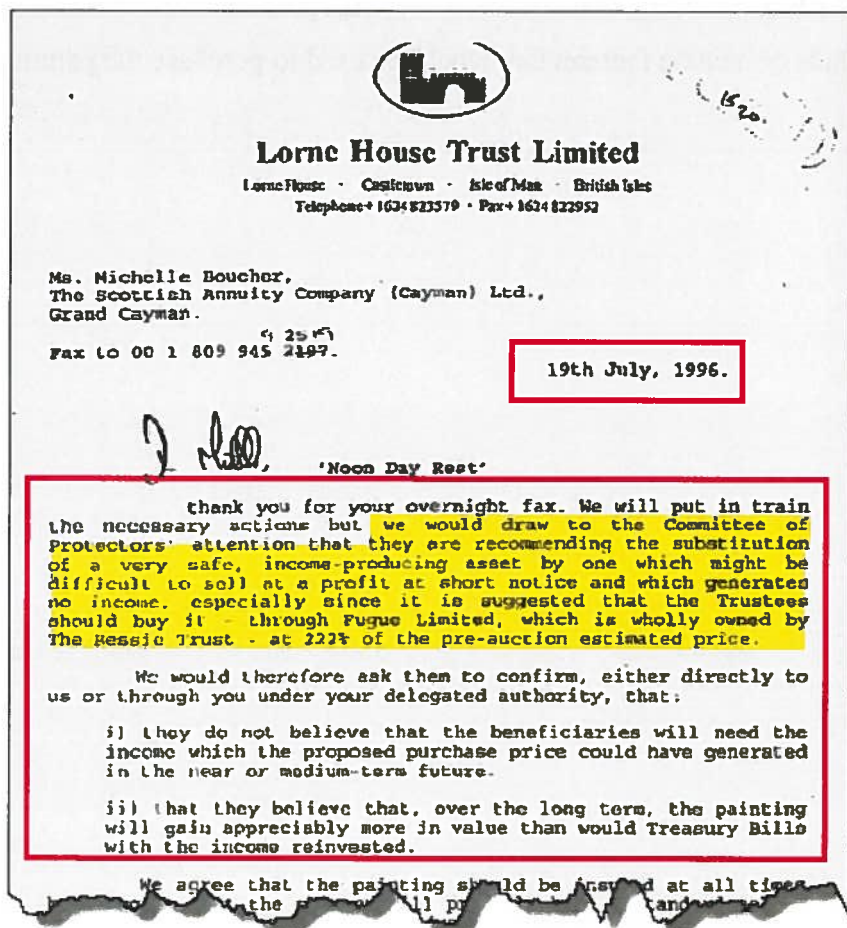
74. As another means to bring untaxed funds back into the U.S., the Wyly Brothers also purchased various pieces of personal property, including jewelry and artwork, through the use of offshore funds. One such example was the purchase of a painting, entitled Noon Day Rest, in July 1996.
75. On July 10, 1996, Cheryl Wyly attended an auction at Sotheby's auction house in London England, and purchased the painting for £155,500, as evidenced by the invoice addressed to her. (*See Figure 38.*)¹¹⁵

¹¹⁵ Sotheby's Invoice dated 07/26/1996, IOM 37813.

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of the Wyly family business, Sterling Software, and Michaels Stores.¹¹⁷ In one of the rare instances of a trustee questioning the Wyllys, the trustee responded that the protectors were recommending the substitution of an income producing asset, for a non-income producing asset, to be purchased at 222% of the pre-auction estimated price.¹¹⁸ The trustee requested confirmation of this request from a beneficiary. (See Figure 39.)

Figure 39: Memo Dated 07/19/1996 from Trustee to Michelle Boucher



77. In an initial response to the trustee, the protectors ignored the trustee's request for confirmation from the beneficiaries, and instead Michael French submitted to the trustee language, taken from the Deed of Settlement of the Bessie Trust, attempting to establish

¹¹⁷ April 7, 2014 Trial Transcript – Vol. Day 01 174:4 -11.

¹¹⁸ Memo from Ronnie Buchanan to Michelle Boucher dated 07/19/1996, PSI00119265 (MF-SEC-RFP1-004972).

that the purchase of personal property was within the powers of the trustee.¹¹⁹ The trustee did not find this to be an adequate response, and again, on July 22, 1996, reiterated the need for written confirmation that consideration had been given to the non-income producing nature of the asset.¹²⁰ The trustee, in good faith, on July 22, 1996, had \$240,000 (approximately the U.S. equivalent of the £155,500), transferred to a holding account for the purchase of the painting.¹²¹ Two days later, on July 24, 1996, Sam Wyly addressed a letter to the trustee stating that neither he nor his spouse would have any foreseeable need for the funds or income thereon that would be used to purchase the painting. (*See Figure 40.*)¹²²

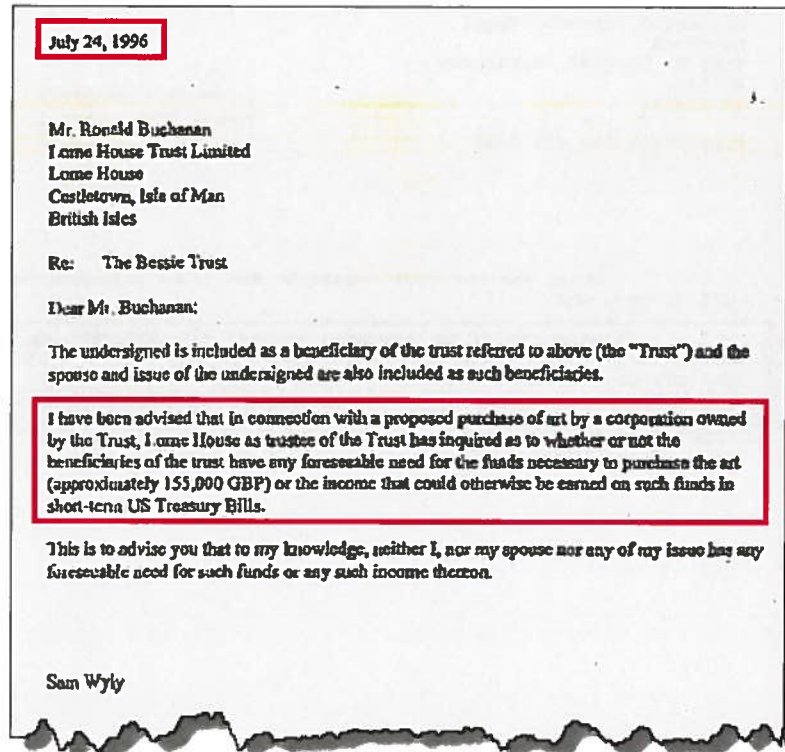
¹¹⁹ Facsimile from Mike French to Ronnie Buchanan dated 07/19/1996, IOM 37820-IOM 37822. Also on July 19, 1996, Mr. Buchanan reached out to a colleague requesting advice on how to handle the matter as he did not wish to “offend” the Settlor (who is also a beneficiary under the trust and, incidentally, a very major client), IOM 37311.

¹²⁰ Memo from Ronnie Buchanan to Michelle Boucher dated 07/22/1996, PSI00117450 (MF-SEC-RFP1-004976).

¹²¹ Transfer instructions dated 07/22/1996, Control Number 76634. Memo from Ronnie Buchanan to Michelle Boucher dated 07/23/1996, PSI00117449 (MF-SEC-RFP1-004977).

¹²² Memo from Sam Wyly to Ronnie Buchanan dated 07/24/1996, PSI001192643 - 001192644 (MF-SEC-RFP1-004979).

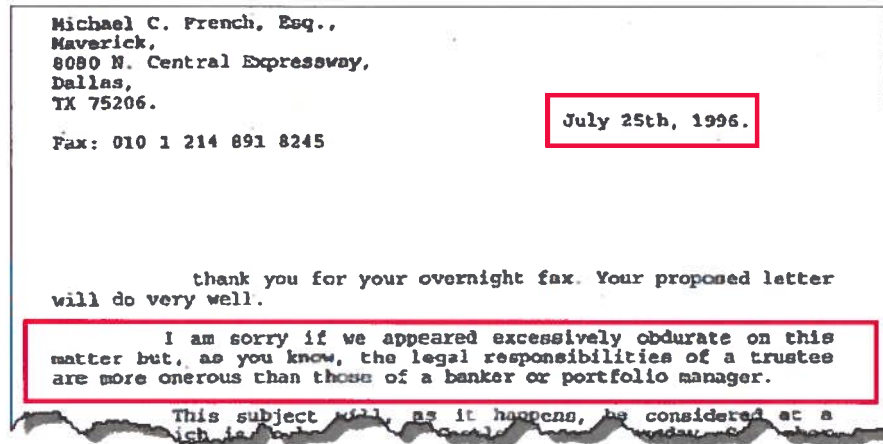
Figure 40: Memo Dated 07/24/1996 from Sam Wyly to Trustee



78. The trustee acknowledged the protector's response and subsequently requested that Sotheby's re-invoice the painting to Fugue Ltd. (See Figure 41 and Figure 42.)¹²³

¹²³ Memo from Ronnie Buchanan to Michael French dated 07/25/1996, PSI00119262 (MF-SEC-RFP1004980). Letter from Barbara Wade to Roger Bell dated 07/25/1996, SEC100317374.

Figure 41: Memo Dated 07/25/1996 from the Trustee to Michael French



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Figure 42: Updated Sotheby's Invoice

SOTHEBY'S
34-35 New Bond Street, London W1A 2AA
Telephone: (0171) 493 8080 Telex: 24454 SPBLON-G
Telex No: (0171) 909 3100
Registered at the above address. Reg. No. 074067
Client Account: 3021714

Buyer's Invoice
Please return top copy with payment
VAT Reg. No. 312 5492 83

Invoice Number: LN64060728
Invoice Date: 26 JUL 96
Sale Title: BRITISH PAINTINGS
Tax Point: 26 JUL 96
Sale Date: 10 JUL 96

Fugue Limited
Mr Ronald Buchanan Esq
c/o Lorne House Trust
Lorne House
CASTLETOWN
Isle of Man
IM9 1AZ

Lot No.	Hammer Price	VAT on Hammer Price		Buyer's Premium	VAT on Buyer's Premium		Total
		Rate	Amount		Rate	Amount	
<p>The following lot(s) have been sold under the margin scheme and input tax deduction has not been and will not be claimed by Sotheby's. No amount has been charged in lieu of VAT, on condition that Sotheby's are responsible for or have proof of exportation from the EU.</p>							
0126	140000.00			15500.00			155300.00
8	140000.00		.00	15500.00		0.00	155300.00
All payments must be made in Pounds Sterling							Total Due

ACCORDING TO OUR CONDITIONS OF BUSINESS, PAYMENT IS DUE IMMEDIATELY AND LATE PAYMENT WILL BE LIABLE TO INTEREST CHARGED AT 18.00 % PER ANNUM

Bankers: Barclays Bank plc
180 Piccadilly
London W1A 2AB
Accounts No.: 60163/00
Sort Code: 20-07-59

Client Account: 3021714
Fugue Limited

Sale Title: BRITISH PAINTINGS
Date: 10 JUL 96

Invoice No.	Date	Amount Due
LN64060728	26 JUL 96	155300.00

79. By re-invoicing the painting to Fugue Ltd. and having the responsibility of payment shifted to this offshore entity, the Wyllys used offshore funds to pay for personal property they could then enjoy in the U.S.¹²⁴ This also demonstrates the level of control the Wyllys actually had over the trust protectors as well as the trustees.

¹²⁴ The Global Family Holding Report as of 02/28/01 for the Audubon (aka Fugue Ltd.) assets show the Noon Day Rest painting listed at a cost basis of \$248,314.19, EYG01011.

e. Investment in Artwork – Caroline Wyly

80. A similar example of artwork purchased for the benefit of the Wylys, yet paid for by a Wyly-established IOM entity, was a purchase by Caroline “Dee” Wyly. On February 11, 1997, Dee agreed to purchase four paintings from Huntsman Gallery of Fine Art for a purchase price of \$8,835. The invoice identified Dee as the purchaser; however it is addressed to Soulieana Ltd. c/o Lorne House. (See Figure 43 Huntsman Gallery Invoice).¹²⁵

Figure 43 Huntsman Gallery Invoice

HUNTSMAN GALLERY OF FINE ART
521 E. HYMAN AVE. PH 970-920-1910
ASPEN, CO 81611
PH. 800-879-8988 FAX 970-925-4870

Customer's Order No.	Phone No.	Date
		2/11/97
Bill To		
DEE WYLY		
Address SOULIEANA LIMITED		
c/o LORNE HOUSE		
City CASTLETOWN, ISLE OF MAN		
PAUL		
City	Description	Price
	DAVID BOWEN NEW	
	CHINA MAN	2800.00
	OIL 12x16	
	AUTUMN LANDSCAPE II	1200.00
	OIL 10x8	
	GARDEN - BLUE SKYMAN	750.00
	OIL 6x7.5	
		4750.00
	LESS COMMISSION	
	DISCOUNT 10%	475.00
		4275.00
	LOINBERG	
	CABIN MOUNTAIN	5000.00
		500.00
	SHIPPING	60.00
All claims and return goods MUST be accompanied by this bill		Tax
		Total
		8835.00
Rec'd By		Payment
		Balance

¹²⁵ Huntsman Gallery of Fine Art Invoice dated 2/11/1997, Confidential Pursuant to Section 24(d) 02030.

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81. Soulieana Ltd. is a Charles Wyly IOM entity, established under the Tyler Trust.¹²⁶ A month later, on March 3, 1997, Sharyl Robertson, protector of the Tyler Trust (Soulieana), sent to Soulieana's trustees a "recommendation" that the artwork that Dee Wyly agreed to purchase from Huntsman Gallery of Fine Art be paid for by Soulieana and that the funds be wired from Soulieana. (See Figure 44 Shari Robertson Recommendation to Trustee

Figure 44 Shari Robertson Recommendation to Trustee

Transmittal

To: Ronnie Buchanan Lorne House Trust	From: Shari Robertson
Date: 03/03/97	Phone: (214) 891-8341
Copy to: Michelle Boucher	Fax: (214) 891-8245
Pages ()	

Regarding: Tyler Trust (Soulieana)

The committee of protectors for the above trust recommend the purchase of the following art work from Huntsman Gallery of Fine Art

Invoice 2/11/97:	
David Borenstein "Chinaman" Oil 12 x 16	2,800
David Borenstein "Autumn Landscape" Oil 10 x 8	1,200
David Borenstein "Blue Floral" Oil 6 x 7.5	750
Dalhart Windberg "Cabin/Moonlight" Oil 1 x 1.25	5,000
Discount	(975)
Shipping	60
Total	8,835

If you go forward with the purchase, kindly wire funds as follows:

**Bank: Pitkin County Bank
ABA: 102103261
Account Name: Huntsman Gallery
Acct #: 150951
Ref: Soulieana**

Shari Robertson

¹²⁶ SEC Case Stipulation of Undisputed Facts at 4.

82. Once again, the Wylys transferred responsibility of personal purchases to their offshore entities and by doing so they were able to use untaxed offshore funds to purchase artwork for their personal enjoyment.

IV. Expert Opinion #2: The Wyly Brothers' transactions involving transfers of stock, options, warrants, and other property to their offshore controlled entities lacked true economic substance and were structured in a manner to avoid paying U.S. individual income and gift taxes.

83. In analyzing the economic substance of the transactions from a forensic accounting perspective, it is imperative to understand the true substance of each transaction as well as the various steps taken to effectuate the transactions. Generally, authorities overseeing accounting principles both domestic and international have long promoted the doctrine of substance over form—that, from an accounting perspective, the true economics of a transaction should take precedence over its documented form. Dating several decades ago (October 1973), a Study Group for the AICPA recommended that with respect to the qualitative characteristics of financial reporting, “The guidelines for reporting information should be expressed so that substance, not form, governs....The substantive economic characteristics, not the legal or technical form, should establish the accounting for transactions and other events.”¹²⁷
84. More recently, the AICPA issued auditing standard AU-C Section 550, which states that, for related parties: “...financial statements prepared in accordance with GAAP generally recognize the substance of particular transactions rather than merely their legal form.”¹²⁸ This principle was reflected as well by the International Accounting Standards Board, which found that “If information is to represent faithfully the transactions and other events

¹²⁷ Report of the Study Group on the Objectives of Financial Statements, American Institute of Certified Public Accountants, October 1973, p. 57 http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1973_1001_TruebloodObjective.s.pdf.

¹²⁸ AU-C Section 550 – Related Parties at AU-C Section 550.A4.

that it purports to represent, it is necessary that they are accounted for and prepared in accordance with their substance and economic reality and not merely their legal form.”¹²⁹

85. In the present matter, the Wyly Brothers orchestrated the formation of a highly complicated offshore infrastructure of related entities over a two-decade period designed to avoid and minimize paying U.S. individual income and gift taxes. Upon close examination, the offshore structure was nothing more than a large group of foreign entities established at the behest of the Wyllys and structured and window dressed to give the illusion that they were independent of the Wyllys’ control. However, in reality, the true substance of the structure was that they all were completely controlled by the Wyllys or their agents and were anything but independent.
86. The concept of certain hallmarks or badges of tax fraud are instructive to review in assessing the offshore tax scheme in this case. A few of the notable badges of tax fraud are the concealment of assets, using a device to hide income or assets, covering up sources of income and misrepresentation of the facts.¹³⁰ As will be discussed in greater detail in this report, the offshore tax scheme implemented by the Wyllys exhibited the characteristics of many of these badges of tax fraud.
87. The documents that I have reviewed underscore that the mere legal form and structure of the offshore transactions belied the ultimate substance and purpose of the Wyllys’ activities: to avoid paying U.S. taxes and having the offshore structure discovered by U.S. taxing authorities. The following examples provide some, but not all instances that support my

¹²⁹ Conceptual framework, IASB 1989: 35 – Qualitative Characteristics of Financial Statements, Reliability. *See also*, 1) FASB Statement of Financial Accounting Concepts No. 8, September 2010 at 27, which states, “Faithful representation means that financial information represents the substance of an economic phenomenon rather than merely representing its legal form. Representing a legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation.”; and 2) Judge Scheindlin’s discussion on “Substance Over Form,” SEC Case Opinion at 21-22. Furthermore, a similar understanding of economic substance is found in I.R.C. §7701, which states, “In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—(A) the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer’s economic position, and (B) the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into such transaction” at 14.

¹³⁰ *See* Section 2.702, 2015 U.S. Edition Fraud Examiners Manual, Association of Certified Fraud Examiners, Austin, Texas, (2015). *See also* Internal Revenue Manual Section 25.1.6.3, Evidence of Fraud (Oct. 30, 2009).

conclusion that the transactions lacked economic substance and were designed to avoid U.S. taxes.

A. Recommendations by the Wyls were always followed

88. The process that was established by the Wyls related to the control of the foreign entities was the following:

- Sam or Charles Wyly would “recommend” a financial transaction to the trust protectors;
- The foreign trust “protectors” would pass this “recommendation” on to the trustee;
- The trustee would purportedly take the “recommendation” into consideration and decide whether or not to execute the transaction.

89. Thus, in theory, the trustee appears to have ultimate and final dominion and control over the offshore funds and have the final decision making capacity as to the transactional activity in the Wyly trusts. In reality, however, this was not true. Control rested entirely with the Wyls. As the district court found in the SEC Case, the Wyly trusts were grantor trusts since the Wyly Brothers had ultimate control over the offshore trusts and the assets they contained. The bankruptcy court applied *collateral estoppel* to this finding (*see discussion supra*). As a result, such trusts and the income derived therefrom under the grantor trust rules of the Internal Revenue Code were subject to U.S. taxation, reportable on the Wyls’ individual income tax returns. Despite the legal form of establishing the trusts as non-grantor trusts and the illusory administrative process of simply “recommending” transactions, the true economic substance was that the Wyly Brothers were in full control of their trusts actually making decisions that affected the economics of the trusts.

90. According to testimony of Michael French, the “recommendations” made by the Wyly Brothers were always followed. During the SEC Case in 2014, Mr. French stated the following:

SEC: Okay. And that's what I want to talk about, the beneficial ownership for SEC reporting. You knew the protectors were making recommendations to the trustees, right?

French: Yes.

SEC: You knew those recommendations were suggested to you by Sam Wyly and Charles Wyly, right?

French: Yes.

SEC: And you knew that in every instance you're aware of, the recommendation was followed by the trustees, right?

French: As far as I knew, yes.¹³¹

91. The fact that the "recommendations" were always followed and were, therefore, actual orders not recommendations, was further confirmed by Sam Wyly himself. In testimony in district court, Sam Wyly stated:

SEC: Okay. Do you dispute, Mr. Wyly, that the trustees followed every recommendation from the protectors?

Sam Wyly: I don't dispute that, no.

SEC: Do you dispute that the trustees never engaged in a securities transaction without a recommendation from the protectors?

Sam Wyly: No.

SEC: Do you dispute that every communication that the protectors made started with you or your brother Charles?

Sam Wyly: No.

SEC: Do you dispute that every recommendation that the protectors made to buy things that you or your brother wanted was followed by the trustees?

¹³¹ April 23, 2014 Trial Transcript from SEC Case - Vol. Day 11 1920:16 - 25.

Sam Wyly: No.¹³²

92. Substantial additional testimony and documents support the court's finding that while on the surface, the Wyly Brothers were only providing "suggestions" to the trustees, they were fully in control and, as such, the substance (*i.e.*, the Wyly Brothers' orders) controlled the form (*i.e.*, the "recommendations"). This process was enforced for the sole purpose of retaining the fiction that these trusts were non-grantor trusts, designed to avoid paying taxes in the U.S.

B. Questionable investments

93. The formation of the offshore trust structure on its face, attempted to accomplish the goal of avoiding detection of numerous transactions and the ultimate goal of avoiding paying U.S. income and gift taxes. In fact, while a true non-grantor trust would provide complete authority over the management of the trust funds to the trustee, the Wyly Brothers in actuality disregarded the trustee's power. The trusts served only as a means to an end—the avoidance of U.S. taxes. Importantly, on rare occasions, the trustee of a Wyly offshore trust would actually question the "recommendation" made by one of the Wyly Brothers, noting that the "recommendation" did not make economic or business sense. The Wyllys, however, dismissed the trustees' concerns and insisted that the trustees proceeded with the order. And that is exactly what then happened, the trustees followed the commands of their masters, the Wyllys; clearly the Wyllys were always in control.
94. For example, as was described in greater detail *supra*, Cheryl Wyly chose to purchase the painting Noon Day Rest in July 1996 from Sothebys. The payment for the artwork, however, was funded entirely by the Wyly offshore entity, Fugue Ltd. As previously noted, the trustee overseeing the funds to this entity responded to the recommendation regarding the substitution of an income producing asset, for a non-income producing asset, to be purchased at 222% of the pre-auction estimated price.¹³³ In the end, however, the Wyllys controlled and the funds from the trust were used to purchase the painting. This is but one

¹³² April 22, 2014 Trial Transcript from SEC Case - Vol. Day 10 1609:7 - 20.

¹³³ Memo from Ronnie Buchanan to Michelle Boucher dated 07/19/1996, PSI00119265 (MF-SEC-RFP1-004972).

of numerous examples of how the offshore trust infrastructure masked the true substance of the Wyly trusts, which vested full control with the Wyls while striving to make it appear that they did not have control so as to avoid paying U.S. taxes.

C. Internal Wyly documents recognized tax issues

95. Documents that were distributed to the Wyly family, including Sam and Charles Wyly, disclose that the Wyls were clearly aware of the tax consequences of their offshore structure and knew from the beginning that by utilizing the offshore trust structure they were avoiding paying U.S. tax. For example, a memo addressed to Sam Wyly regarding certain Computer Associate options, which was attached to an email from Keeley Hennington, the CFO of the Wyly family office, to Michelle Boucher on February 26, 2002, stated the following:

There needs to be a good answer to the increase in shares from what was publicly represented during the CA proxy fight. I think that those watching this closely will raise this issue and there need to be an answer that does not jeopardize the offshore system.

I think the concerns initially were to make sure that it did not appear that the trustees were taking any direction from you and using trust assets to benefit you personally.....

....I could see CA possibly making a big deal out of this if they think it would focus some of the attention away from them and cause problems for you.

Our friendly IRS agent is still looming around and although he has verbally agreed to not look further at any foreign entities or trusts, I would not want to give him any fresh ammunition.¹³⁴

¹³⁴ Email from Keely Hennington to Michelle Boucher, February 26, 2002, SEC/ITC0105444- SEC/ITC0105445 (emphasis added).

96. Furthermore, another internal memorandum from Keeley Hennington and Michelle Boucher dated July 2, 2003 informs the Wyllys of the following issues:

- Legal analyses performed by the law firm Morgan Lewis concluded that trusts were grantor trusts and should be taxed by the IRS;
- An analysis of regulations and court decisions lead to a conclusion that the Wyly trusts are grantor trusts and should be taxed by the U.S.;
- The annuity payments would bankrupt several of the IOM companies; and
- Annuity payments would trigger an IRS audit.¹³⁵

97. If the offshore trusts were truly established primarily for legitimate non-tax purposes, and structured so the Wyllys did not have control, the concerns raised by the Wyly family business should not have been an issue. Yet despite their concern, the Wyllys retained the offshore infrastructure for more than a decade after these memorandums were written. While the July 2, 2003 memorandum even suggested a proactive resolution with the IRS, no such agreements were ever made. The Wyllys continued to maintain the status quo and, despite the window dressed appearance that these entities were non-grantor trusts that should not be subject to U.S. taxation, the facts and substance of the offshore trust system is that the Wyllys utilized their controlled offshore entities to avoid paying U.S. taxes.

D. The Wyllys retained ownership and the economic benefits of the offshore assets

98. The fact that the Wyllys' offshore trust structure lacked economic substance comes down to a simple reality—experienced and wealthy businessmen, like the Wyllys, do not give up control of their fortune. If the offshore trusts were truly and substantively non-grantor trusts and were established for legitimate non-tax reasons, the Wyllys would have had no influence or control over the underlying assets. Yet, as detailed above, Sam and Charles Wyly continued to maintain control over their money and continuously directed the activities in the offshore entities (*i.e.*, used un-taxed money to purchase jewelry and art,

¹³⁵ Memo from Keeley Hennington and Michelle Boucher, July 2, 2003, WYLYSEC01112396-01112411.

buy real estate and make investments). The district court in the SEC Case confirmed this by stating:

Reasonable and savvy businessmen do not engage in such activity unless it is profitable. Of course it was profitable—by transferring property, including valuable options and warrants, to the trust, exercising the options and trading in secret, and using the proceeds to reinvest in other ventures, the Wylys were able to accumulate tremendous tax-free wealth.¹³⁶

E. Decisions made to obfuscate tax liabilities from U.S. authorities

99. When Louis Schaufele, the Wylys' investment broker, began working at Bank of America in early 2002, he transferred the Wyly brokerage accounts with him from his previous firm. Upon opening the new accounts, Bank of America was required, under the 2001 Patriot Act, to verify the identity of their customers.¹³⁷ However, the Wylys resisted requests from the bank to provide the underlying beneficial ownership of the trusts, and demanded to have their identities kept from Bank of America, further demonstrating the lengths at which they went to avoid having their offshore structure detected by the IRS or other U.S. authorities.
100. For example, in an email dated March 12, 2002, two Bank of America representatives were concerned about the bank's regulatory compliance related to the Know Your Customer (KYC) rules and discussed the new accounts established by Schaufele stating that Schaufele would not reveal the clients' name because "the family was extremely worried about being linked to these accounts."¹³⁸ However, Bank of America persisted and requested proof of identification for all corporate officers.¹³⁹ In response to this request, Bank of America was provided with only the identification of the trustees rather than of the underlying beneficiaries.¹⁴⁰ By withholding the beneficiary information from Bank of

¹³⁶ SEC Case Opinion at 28.

¹³⁷ Subcommittee Report, at 324.

¹³⁸ March 12, 2002 email from Carole Bonina to Cindy Kellen, BA 055983.

¹³⁹ March 15, 2002 email from Michele Crittenden to Anna Benbatoul, BA 055866.

¹⁴⁰ March 27, 2002 email from Cindy Kellen to Michele Crittenden, BA 055795.

America, the Wylys were able to continue to obfuscate from the IRS the true nature of the offshore foreign structure.

V. Expert Opinion #3: The Wyly Brothers' original U.S. federal income tax filings from 1992 – 2013 were false and misleading and concealed the true nature and substance of the transfer of stock options, warrants, and stock, and other transactions described above.

101. According to 26 U.S. Code §61 (“Internal Revenue Code”), as well as the instructions to the Form 1040, the standard form that individuals submit to the IRS reporting annual income tax:

- Generally, you must report all income except income that is exempt from tax by law.
- You must report unearned income, such as interest, dividends, and pensions, from sources outside the U.S. unless exempt by law or a tax treaty. You must also report earned income, such as wages and tips, from sources outside the U.S.¹⁴¹

102. The Wyly Brothers, however, through the creation and use of their controlled offshore trusts, attempted to shift income to their offshore entities and as a result did not properly report their income to the IRS. Instead, they excluded hundreds of millions of dollars in income and capital gains from their federal income tax returns for the years 1992-2013. Since the offshore trusts were grantor, not non-grantor trusts, with beneficial ownership and control tied directly back to Sam and Charles Wyly, all of the income purportedly derived from the property transferred (and/or gains and losses from the underlying securities once the stock options were exercised) to these controlled entities should have been reported on the relevant income tax returns beginning in 1992. It was not.

103. As shown in the examples below, the original U.S. individual tax filings signed and filed under the penalties of perjury¹⁴² by the Wyly Brothers were not only deficient, but were

¹⁴¹ See 26 U.S. Code §61 and Instructions for Form 1040 (1992) at 13.

false and misleading due to the extensive omissions detailed hereinafter. While I am including only a few detailed examples below for demonstrative purposes, Appendix C attached to my Expert Report provides additional examples throughout the more than two-decade period of the omissions and inaccuracies included in the Wyllys' tax filings.¹⁴³

A. False statements

1. Example 1 - Sam Wyly 1992 Gains from Sales of Publicly Traded Securities

104. On March 11, 1992, Sam Wyly, as the settlor, entered into a trust agreement with the IOM Bulldog Non-Grantor Trust.¹⁴⁴ As discussed *supra*, 485,000 call options and 100,000 warrants of Michaels Stores and 667,000 call options and 644,725 warrants of Sterling Software were assigned to entities owned by the Bulldog Trust. During 1992, several of these options and warrants were exercised and the underlying securities sold. Yet, the income produced in these transactions was never reported to the IRS by Sam Wyly despite the fact that the Bulldog Trust was a grantor trust. Since Sam Wyly was ultimately the beneficial owner of these assets, his tax filings should have reflected the income from the securities. They did not.
105. For example, on April 15, 1992, Sam Wyly assigned 667,000 Sterling Software options to East Carroll, an entity owned by the Bulldog Trust.¹⁴⁵ One month later, these options were exercised.¹⁴⁶ The options had an exercise price of \$6.25 and on the day they were

¹⁴² The signature line on Form 1040 states the following: "Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete." U.S. Individual Income Tax Return Form 1040. In fact, all of the tax returns that I examined were signed by Sam and Charles Wyly respectively.

¹⁴³ Due to the complicated nature of the Wyllys' income tax returns, there may be other examples of items that were reported in a false and misleading manner that I have not detailed in this report or the appendix hereto, but nonetheless support my opinions in this regard.

¹⁴⁴ March 11, 1992 Trust Agreement of the Bulldog Non-Grantor Trust, SW-IDR01-0000000002 – 00000000036. As noted above, despite the fact that the name of the trust included the words "Non-Grantor," the Court has applied *collateral estoppel* to the fact that the Wyllys' offshore trusts were grantor trusts. See, *In re Wyly*, No. 14-35043-BJH (Bankr. N.D. Tex. Aug. 24, 2015).

¹⁴⁵ Private Annuity Agreement between Sam Wyly and East Carroll Limited, JWLLP- SEC02649 – 02659; Assignment of Non-Statutory Stock Options, JWLLP-SEC02661, Consent to Transfer of Non-Statutory Stock Options, JWLLP- SEC02663 – 02665.

¹⁴⁶ CS First Boston Stock Sale Sheet, CSFB 0004076.

exercised the fair market value was \$17.125.¹⁴⁷ Ordinary income should have been reported on the difference between the exercise price and the fair market value (*i.e.*, $\$17.125 - \$6.25 = \$10.875$). The difference of \$10.875 times the number of shares, 667,000, would have resulted in ordinary income of \$7,253,625.¹⁴⁸ (See Figure 45, which is an internal document that shows the market value at date of exercise and the calculated ordinary income.)

Figure 45: 667,000 Sterling Software Options Exercised

Options Exercised	Date	# options	MV at date of exercise	gain/(loss) vs mkt at ann valn	gain/(loss) vs Strike Price	strike price paid
SSWO Sterling Software Optn exp May 1, 1994 strike \$6.25	04/15/92	667,000				
Exercised Options	05/12/92	667,000	17.125	(1.750)	10.875	6.250
Total dollars balance			11,422,375	(1,167,250)	7,253,625	4,168,750

Source: WYLYSEC01102043

106. In addition to the ordinary income resulting from the exercise of stock options, capital gain or loss should have been reported when these stocks were then sold. For example, on November 27, 1992, 149,300 shares with a basis of \$17.125 were sold at a fair market value of 19.251. This resulted in a short-term gain of \$317,352.08 (*i.e.*, $\$19.251 - \$17.125 = \$2.126$; $\$2.13 \times 149,300 = \$317,352.08$).¹⁴⁹ (See Figure 46, a November 1992 CS First Boston stock sale sheet showing the Sterling Software sale.)

¹⁴⁷ Internal document showing private annuity details at WYLYSEC01102043.

¹⁴⁸ I was provided with numerous binders from the IRS that contain income and gift tax determinations as well as penalty calculation schedules for both Sam and Charles Wyly for the years 1992 – 2013. I define these herein as “IRS Binder- Schedules.” IRS Binder- Schedule S-1, Year: 1992 Gains from Sales of Publicly Traded Securities attributable to Samuel E. Wyly.

¹⁴⁹ Internal document showing private annuity details at WYLYSEC01102043; Trading activity for November 1992 at CSFB0004082; IRS Binder Schedule S-1, Year: 1992 Gains from Sales of Publicly Traded Securities attributable to Samuel E. Wyly.

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Figure 46: CS First Boston Stock Sale Sheet

11/30/92*R9M4R*RG* 1

GRID: J15

INV REP ACCOUNT TAXPAYER ID. STATEMENT PERIOD PAGE
R803 R9M4R 999999999 11/01/92 TO 11/30/92 2 OF 3

TRADING ACTIVITY FOR THE MONTH

TYPE	DATE	TRANSACTION	QUANTITY	DESCRIPTION	PRICE	DEBIT	CREDIT
2	11/12/92	SOLD	1,380	STERLING SOFTWARE INC	20.43270		28,406.82
2	11/13/92	SOLD	1,000	STERLING SOFTWARE INC	20		19,940.33
2	11/16/92	SOLD	17,700	STERLING SOFTWARE INC	20.00910		353,204.26
2	11/18/92	SOLD	1,890	STERLING SOFTWARE INC	20		37,800.73
2	11/19/92	SOLD	1,890	STERLING SOFTWARE INC	20		37,800.73
2	11/19/92	SOLD	1,890	STERLING SOFTWARE INC	20		37,800.73
2	11/19/92	SOLD	23,368	STERLING SOFTWARE INC	20		467,328.16
2	11/27/92	SOLD	149,300	STERLING SOFTWARE INC	19.25880		2,878,618.51
						2,866,553.77	

3,878,618.51
51

INCOME ACTIVITY FOR THE MONTH

TYPE	DATE	TRANSACTION	DESCRIPTION	DEBIT	CREDIT
2	11/30/92	INTEREST	FUNDS DEPOSITED HAVE EARNED INT AT ANNU RATE OF 83.168 X FROM 1/1/92 TO 11/29 CLOSE BAL 3870886.51CR AVG BAL 1175555.06CR		1,896.33

CSFB0004082

107. In aggregate for all transactions that were exercised in 1992, 1,896,725 stock options were exercised, and of those exercised options 902,000 shares of stock were sold from the Bulldog trust.¹⁵⁰ Thus, in total in 1992, Sam Wyly failed to report a total of \$18,500,500 of ordinary income and a net \$709,075 of short-term capital gains.¹⁵¹ Had this income been included on the 1992 Form 1040 of Sam Wyly, his total "Wages, salaries, tips, etc." would have been \$19,245,461 (\$744,961 as previously reported plus \$18,500,500) thereby making total Adjusted Gross Income \$22,203,803 (\$3,703,303 as previously reported plus \$18,500,500).¹⁵² (See Figure 47: Sam Wyly 1992 Form 1040.) This is but one example of the Wyllys' failure to report income; similar omissions occur every year for nearly two decades.

¹⁵⁰ Internal document showing private annuity details at WYLYSEC01102042-01102048; IRS Binder- Schedule S-1, Year: 1992 Gains from Sales of Publicly Traded Securities attributable to Samuel E. Wyly.

¹⁵¹ IRS Binder- Schedule S-1, Year: 1992 Gains from Sales of Publicly Traded Securities attributable to Samuel E. Wyly. Although \$709,075 of additional short-term capital gains are added, the short-term capital loss carryforward from 1991 was greater than this amount, therefore, the capital loss of (\$3,000) remains unchanged.

¹⁵² Sam Wyly 1992 Form 1040, SECI00099759; IRS Binder- Schedule S-1, Year: 1992 Gains from Sales of Publicly Traded Securities attributable to Samuel E. Wyly.

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Figure 47: Sam Wyly 1992 Form 1040

Original		
7	Wages, salaries, tips, etc. Attach Form(s) W-2	7 744,961.
8a	Taxable interest income. Attach Schedule B if over \$400	8a 2,022,754.
b	Tax-exempt interest income (see page 15). DON'T include on line 8a	8b
9	Dividend income. Attach Schedule B if over \$400	9 236,174.
10	Taxable refunds, credits, or offsets of state and local income taxes from worksheet on page 15	10
11	Alimony received	11
12	Business income or (loss). Attach Schedule C or C-EZ	12 2,103,882.
13	Capital gain or (loss). Attach Schedule D	13 -3,000.
14	Capital gain distributions not reported on line 13 (see page 15)	14
15	Other gains or (losses). Attach Form 4797	15 -4.
16a	Total IRA distributions	16a
b	Taxable amount (see page 16)	16b
17a	Total pensions and annuities	17a
b	Taxable amount (see page 16)	17b
18	Rents, royalties, partnerships, estates, trusts, etc. Attach Schedule E	18 -921,864.
19	Farm income or (loss). Attach Schedule F	19
20	Unemployment compensation (see page 17)	20
21a	Social security benefits	21a
b	Taxable amount (see page 17)	21b
22	Other income. List type and amount - see page 18	22
23	Add the amounts shown in the far right column for lines 7 through 22. This is your total income	23 4,182,903.
24a	Your IRA deduction from applicable worksheet on page 19 or 20	24a
b	Spouse's IRA deduction from applicable worksheet on page 19 or 20	24b
25	One-half of self-employment tax (see page 20)	25
26	Self-employed health insurance deduction (see page 20)	26
27	Keogh retirement plan and self-employed SEP deduction	27
28	Penalty on early withdrawal of savings	28
29	Alimony paid. Recipient's SSN SEE S. 1	29 479,600.
30	Add lines 24a through 29. These are your total adjustments	30 479,600.
31	Subtract line 30 from line 23. This is your adjusted gross income. If this amount is less than \$22,370 and a child lived with you, see page EIC-1 to find out if you can claim the "Earned Income Credit" on line 56	31 3,703,303.

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Adjusted		
7	Wages, salaries, tips, etc. Attach Form(s) W-2	7 19,245,461
8a	Taxable interest income. Attach Schedule B if over \$400	8a 2,022,754.
b	Tax-exempt interest income (see page 15). DON'T include on line 8a	8b
9	Dividend income. Attach Schedule B if over \$400	9 236,174.
10	Taxable refunds, credits, or offsets of state and local income taxes from worksheet on page 16	10
11	Alimony received	11
12	Business income or (loss). Attach Schedule C or C-EZ	12 2,103,882.
13	Capital gain or (loss). Attach Schedule D	13 -3,000.
14	Capital gain distributions not reported on line 13 (see page 15)	14
15	Other gains or (losses). Attach Form 4797	15 -4.
16a	Total IRA distributions	16a
b	Taxable amount (see page 16)	16b
17a	Total pensions and annuities	17a
b	Taxable amount (see page 16)	17b
18	Rents, royalties, partnerships, estates, trusts, etc. Attach Schedule E	18 -921,864.
19	Farm income or (loss). Attach Schedule F	19
20	Unemployment compensation (see page 17)	20
21a	Social security benefits	21a
b	Taxable amount (see page 17)	21b
22	Other income. List type and amount - see page 18	22
23	Add the amounts shown in the far right column for lines 7 through 22. This is your total income	23 22,683,403
24a	Your IRA deduction from applicable worksheet on page 19 or 20	24a
b	Spouse's IRA deduction from applicable worksheet on page 19 or 20	24b
25	One-half of self-employment tax (see page 20)	25
26	Self-employed health insurance deduction (see page 20)	26
27	Keogh retirement plan and self-employed SEP deduction	27
28	Penalty on early withdrawal of savings	28
29	Alimony paid. Recipient's SSN SEE S 1	29 479,600.
30	Add lines 24a through 29. These are your total adjustments	30 479,600.
31	Subtract line 30 from line 23. This is your adjusted gross income. If this amount is less than \$22,370 and a child lived with you, see page EIC-1 to find out if you can claim the "Earned Income Credit" on line 56	31 22,203,803

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Form 1040 (1992)

108. Due to a large short-term capital loss carryforward from 1991, the \$709,075 short-term capital gain would have been fully offset.¹⁵³ However, this unreported short-term capital gain would reduce this loss carryforward for the following tax year. Had the \$709,075 short-term capital gain been reported, the short-term capital loss carryforward would have only been (\$524,323) and not (\$1,233,398) as was reported on Schedule D.¹⁵⁴ (See Figure 48.)

¹⁵³ A capital loss carryforward is the net amount of capital losses that are not able to be deducted in the current year, due to maximum loss restrictions. These losses are able to be carryforward and applied to future year's tax returns. Future capital gains can be netted with carryforward losses. See, in general, IRS Topic 409-Capital Gains and Losses.

¹⁵⁴ Sam Wyly 1992 Form 1040, Schedule D at SECI00099767 - SECI00099768. Capital gains and losses are reported on Schedule D of the personal tax return.